Fixed capital investment, which excludes changes in inventories, comprises business investment in equipment and intellectual property, such as research and development, government investment and housing. In total, as I show in chart one, there has been a slight pick up since the trough of 2010 but, as a percentage of gross domestic product, it is still lower than it has been in any year between 1948 and 2008. This is the case for business investment in plant and equipment as well as for investment in total.

The capital stock of the US grows when there is net new investment which requires gross investment to be greater than capital consumption. Recently, as chart two shows, the net additions to the US capital stock have turned negative. From 1947 to 2008 the net additions to the capital stock averaged 3.3 per cent of GDP. As GDP grew in real terms at 3.3 per cent a year, it would seem reasonable to assume that the current level of investment is insufficient for growth, except in so far as there are unused resources of capital and labour in the economy.

This depressing view is supported by the change that has occurred in US labour productivity. Measured by the change in GDP at constant prices per hour worked, productivity has fallen very sharply. The Bureau of Labor Statistics data, which start in 1964, show that productivity has risen by 1.45 per cent a year since 1964 but only by 0.47 per cent over the past three years (chart three).
As chart three shows, US labour productivity has been very volatile and it may now pick up. It needs to do so if expectations about the potential growth of the US economy are not to prove far too optimistic.

I attribute the low level of investment and the poor productivity of both the UK and the US economies to the change in management remuneration. This encourages managers to push up their profit margins and to reduce their investment in plant and equipment. As I showed in chart three of my blog entitled “US equities: more buyers than sellers”, companies are spending record low levels of their cash flow on new capital investment, including both equipment and intellectual property, and paying out record high levels of cash to shareholders through dividends and buybacks.

It seems likely to me that investment will rise. Although modern management remuneration practices are a major factor in constraining investment, they are not the only one. As I pointed out in response to a recent comment, one strong piece of evidence for my thesis is that unquoted companies, where the perverse incentives that discourage investment are much weaker, appear to be similar in total size to quoted ones but to invest twice as much as quoted companies (see “Corporate Investment and Stock Market Listing: A Puzzle?” by John Asker, Joan Farre-Mensa and Alexander Ljungqvist, a European Corporate Governance Institute finance working paper). Over time it is therefore likely that the current inhibitions against investment will weaken.

There are many ways in which this may occur. For example, unquoted companies, which include the subsidiaries of foreign companies, seem likely to outperform the quoted sector because of their higher level of investment and investors may notice this. Those interested in long rather than short-term performance, such as tracker funds, may then bring new pressures to bear on quoted companies to change their behaviour and the way they incentivise their managements.

But, while investment should rise, it will have to rise a lot if the growth of the US economy is not to be much slower in the future than it has been in the past. Capital consumption does not change much from year to year, so a rise in gross investment would for the most part be represented in a similar rise in net investment. Even then it would still take a rise in gross investment of 3.7 percentage points of GDP to bring net additions to the capital stock up to the average level seen from 1947 to 2008.

Even if a large rise in investment takes place, it will take time and there will probably be a lag between the rise in investment and an increase in the US economy’s trend growth rate.
It may be possible for US labour productivity to improve without a rise in investment. I am sceptical. It will, I think, be difficult for the output per hour of US workers to rise unless they have more capital to employ and this, if the data are correct, will require both time and a large rise in investment.

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